# Saving and Strengthening Social Security for the New Millennium

# Social Security is Our Nation's Most Vital Social Program


- FDR's moral vision of a democratic people coming together to provide for the common good

- Has dramatically reduced poverty among the elderly. In 1960, more than 1/3 of all elderly Americans lived below the poverty line. Today, less than 13 percent of elderly people are poor

# FDR Insisted on Certain Principles

- SS to be more private pension than welfare
- SS was to be self-financing with a dedicated payroll tax, where benefits related to contributions (***FDR: "with those taxes there, no damn politician can every scrap my social security program."***)
- No General Revenues
- SS should be ***<u>funded</u>*** and actuarially sound, just like every other pension and insurance program

# Despite FDR's Intentions, Social Security Evolved as "Pay-As-You-Go," Not a Funded Program

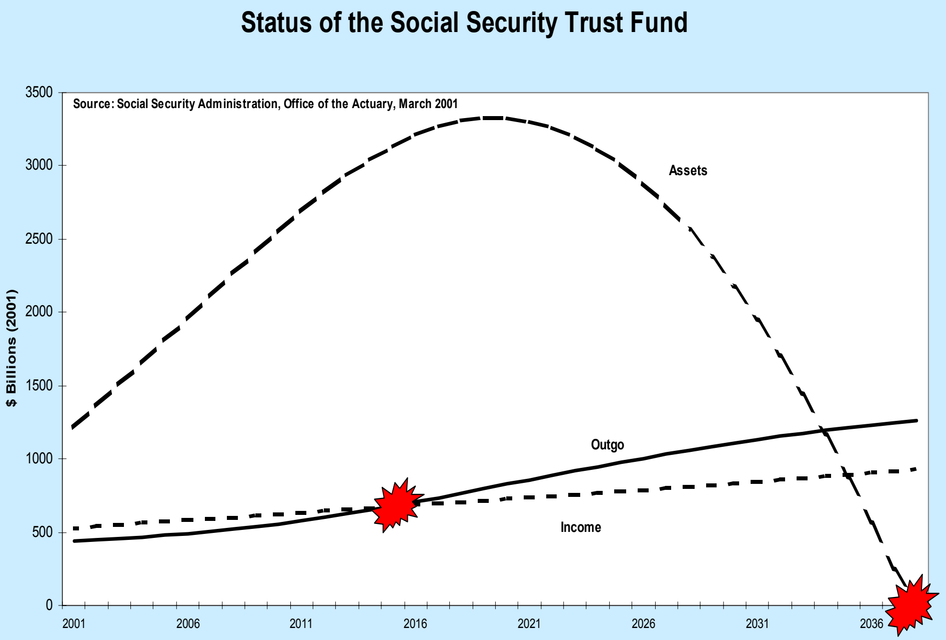
- Instead of setting monies aside for the future as FDR had intended, SS's PAYGO evolution means that benefits this year are paid from taxes collected this year
  - Taxes on workers' wages (FICA)
  - Taxes on Social Security benefits

- Social Security is an income transfer program

- Future benefits are payable based solely on two factors:
  - Whether future taxes are sufficient to cover future benefit costs
  - The willingness of future generations to pay higher taxes when costs exceed revenues

# It's No One's Fault, but Social Security Faces a Looming Cash Crunch...

- By 2018, program costs will exceed payroll tax revenue.
- By 2042, the Trust Fund will be bankrupt and Social Security will be able to pay only 73 cents on every dollar in benefits owed.

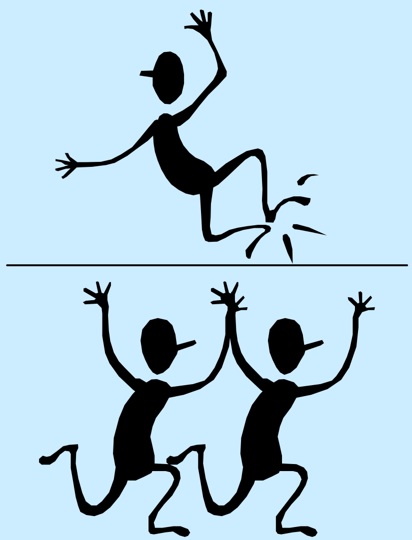


# Why? <u>Demographics.</u> Americans are living longer and having fewer children

**Consequently, fewer workers are available to support each Social Security recipient**

**1960: 5.1 to 1**
Tax rate 6% on $4,800*

**Today: 3.4 to 1**
12.4% on $84,900*



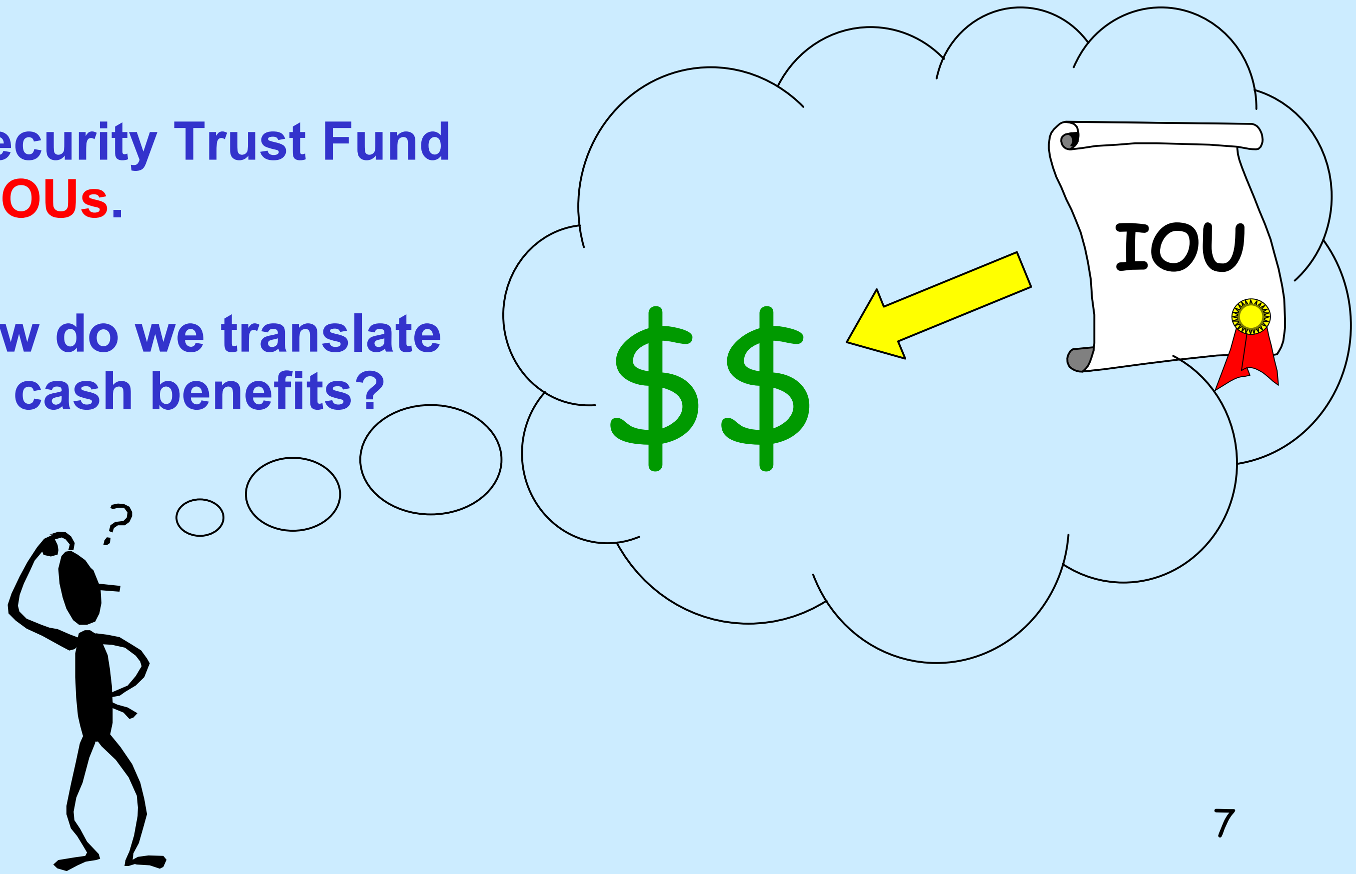
**2030: 2.1 to 1**
17.8% on $249,000*



* Not adjusted for inflation

# But What About the Trust Fund?

- Trust Fund "Solvency" is Misleading.
- The Social Security Trust Fund is filled with IOUs.
- Problem:  How do we translate the IOUs into cash benefits?



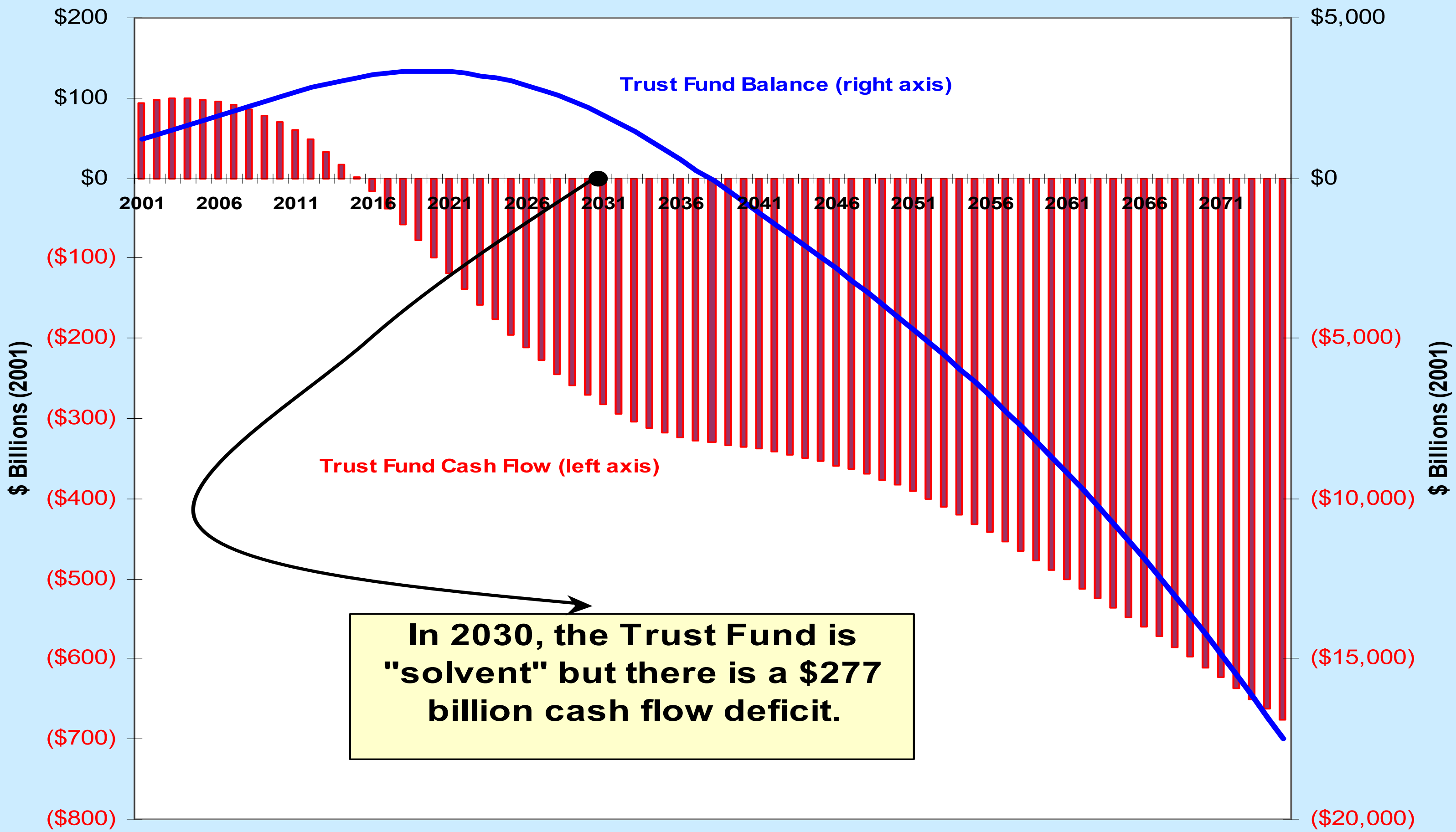
# What Is the Trust Fund?

- Today’s surplus payroll taxes flow into the treasury, and Social Security’s trust funds are credited with federal securities (non-marketable bonds). The federal government then uses the money to meet whatever expenses are pending

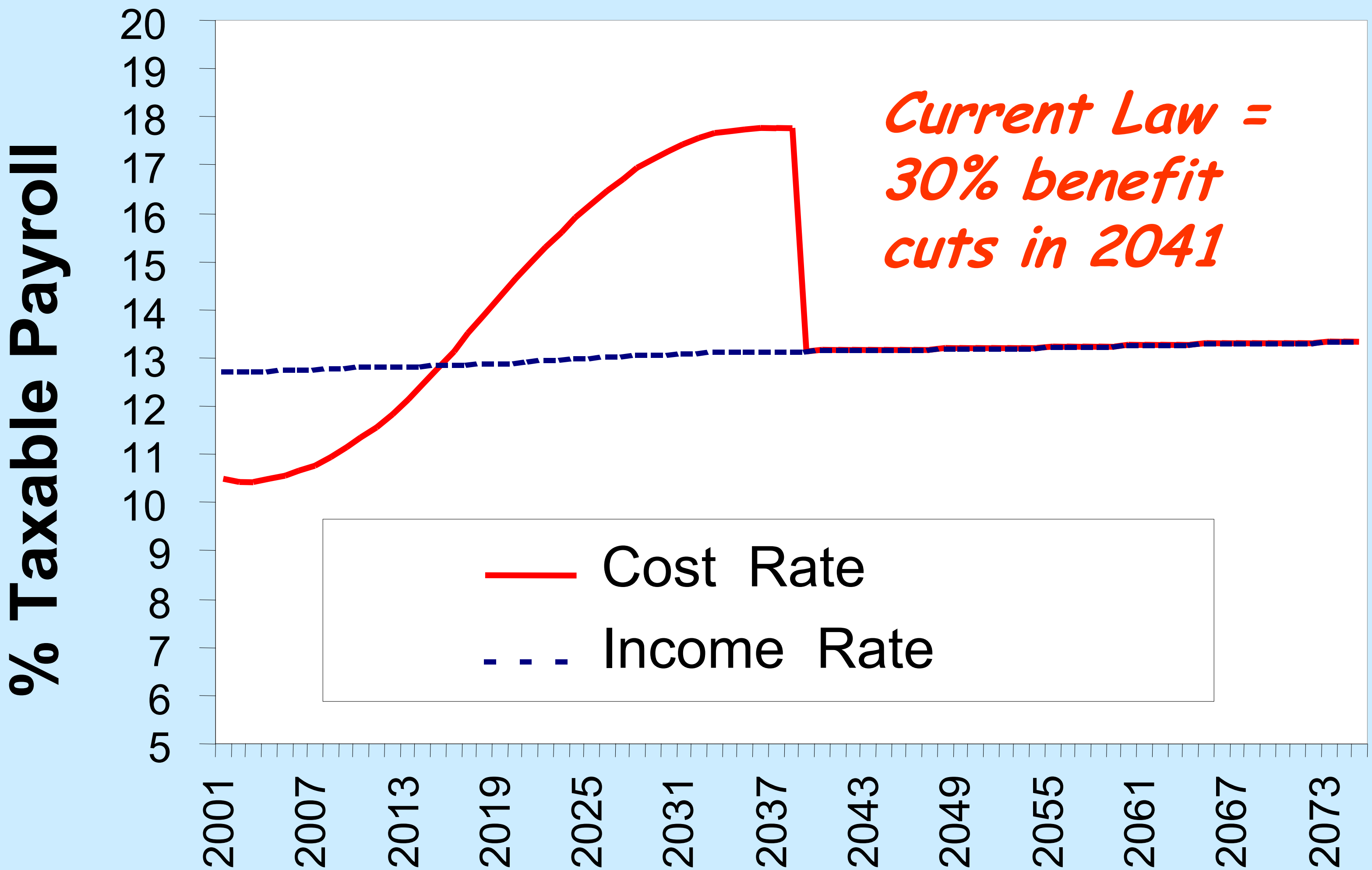
- Balances represent monies the federal government has borrowed from Social Security and promises to pay back, with interest, sometime in the future

- The key point is that the trust funds themselves do not hold resources to pay benefits -- rather, they provide authority for the Treasury Department to use whatever money it has on hand to pay them

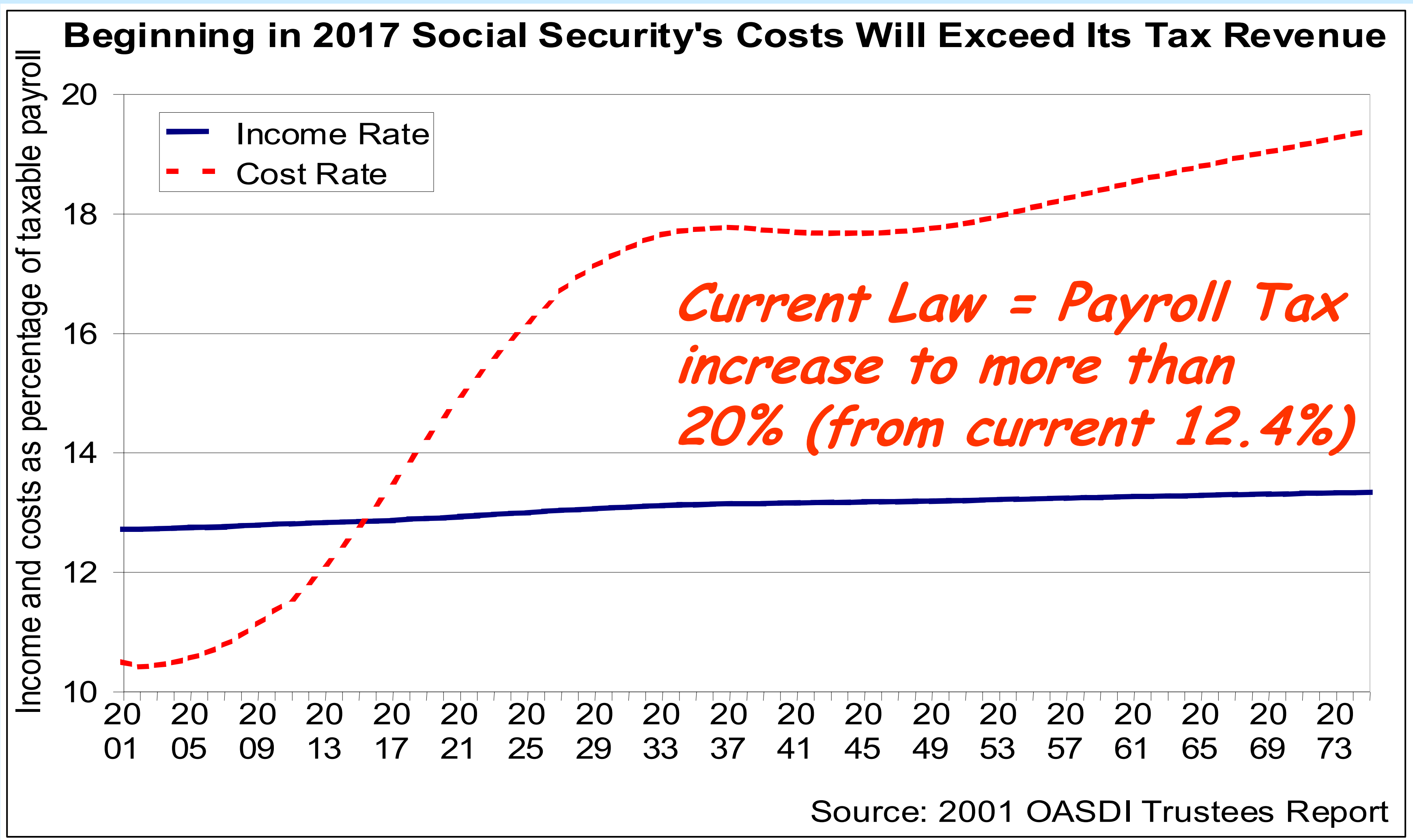
# … It's Cash Flow that Matters



# In the Absence of Reform, the Options Range from Drastic Benefit Cuts …….



# … to Massive Tax Increases!!!



# Social Security Also is Out of Touch with the Modern Family

- Social Security's benefit structure is based on a portrait from 1940: husband as the sole wage earner with a dependent wife who remains at home.

- As two-earner households become the norm, and the "typical" family becomes harder to define, the failure of Social Security to adapt results in glaring inequities.
  - Social Security rewards single-earner families over dual-earner families
  - A spouse who earns less than the primary wage earner receives little or no additional Social Security benefit for his/her work.
  - Social Security has not kept pace to meet the changing nature of divorce.

# Two Couples, Identical Earnings, Different Benefits...

**Tom and Beth Green (age 35)**

- Tom Green is the sole breadwinner, earning twice the average wage
- Tom retires in 2032
- Social Security benefit: $2098/mo. + $1049/mo. spousal benefit = $3147/mo.
- Tom dies, Beth's widow's benefit = $2098/mo = 66% of initial benefit

**Mike and Sue Smith (age 35)**

- Mike and Sue both work and together earn twice the average wage
- Mike and Sue retire in 2032
- Social Security benefit: $1447/mo. each = $2894 combined. $253 less per month than the Greens
- When Mike dies, Sue's widow's benefit = $1447 per month = 50% of initial benefit

# Social Security and the Changing Nature of Divorce …

**Spousal and survivor benefits are extended to ex-spouses married 10 years or more. Today, <u>more</u> people get divorced after <u>fewer</u> years of marriage.**

- **John and Judy Hill end their marriage after 9 years and 11 months. George and Rita Ball obtain a divorce after 10 years and 1 month of marriage. Despite a difference of only 2 months in the length of their marriages, Judy Hill receives no Social Security benefits while Rita Ball gets full spousal and survivors benefits.**

- **Ed Hunter is married 5 times, each more than 10 years. John Joiner is married to the same woman for 60 years. None of their wives work outside the home. The two men earn the same wages and pay the same taxes but Ed costs the taxpayers more money than John because the government must pay Social Security benefits for all five of his wives.**

# African Americans are Disadvantaged by Social Security

- Social Security essentially transfers income from low-income working African Americans to white, nonworking women.
    - On average, African Americans receive nearly **$21,000 less** from Social Security than whites with similar income and family profiles.
        - African Americans have a shorter life expectancy
        - Nearly half of all marriages among African Americans are disrupted by divorce in less than 10 years
        - A greater number of African American women do not remarry after divorce
- African Americans are more vulnerable to Social Security's financial crisis because on average, they have less personal savings.

# Younger Generations Have More at Stake

- ***Our children and grandchildren*** will bear the brunt of funding Social Security when the financial crisis hits.
  - Today's 13-year olds will be 27 when Social Security's costs exceed revenues.
  - They will be working to pay off school loans, car loans and saving to purchase their first home or fund their own retirement.

- At the same time, as the ratio of workers to retirees drops, the tax burden on today's young people will increase 50%.

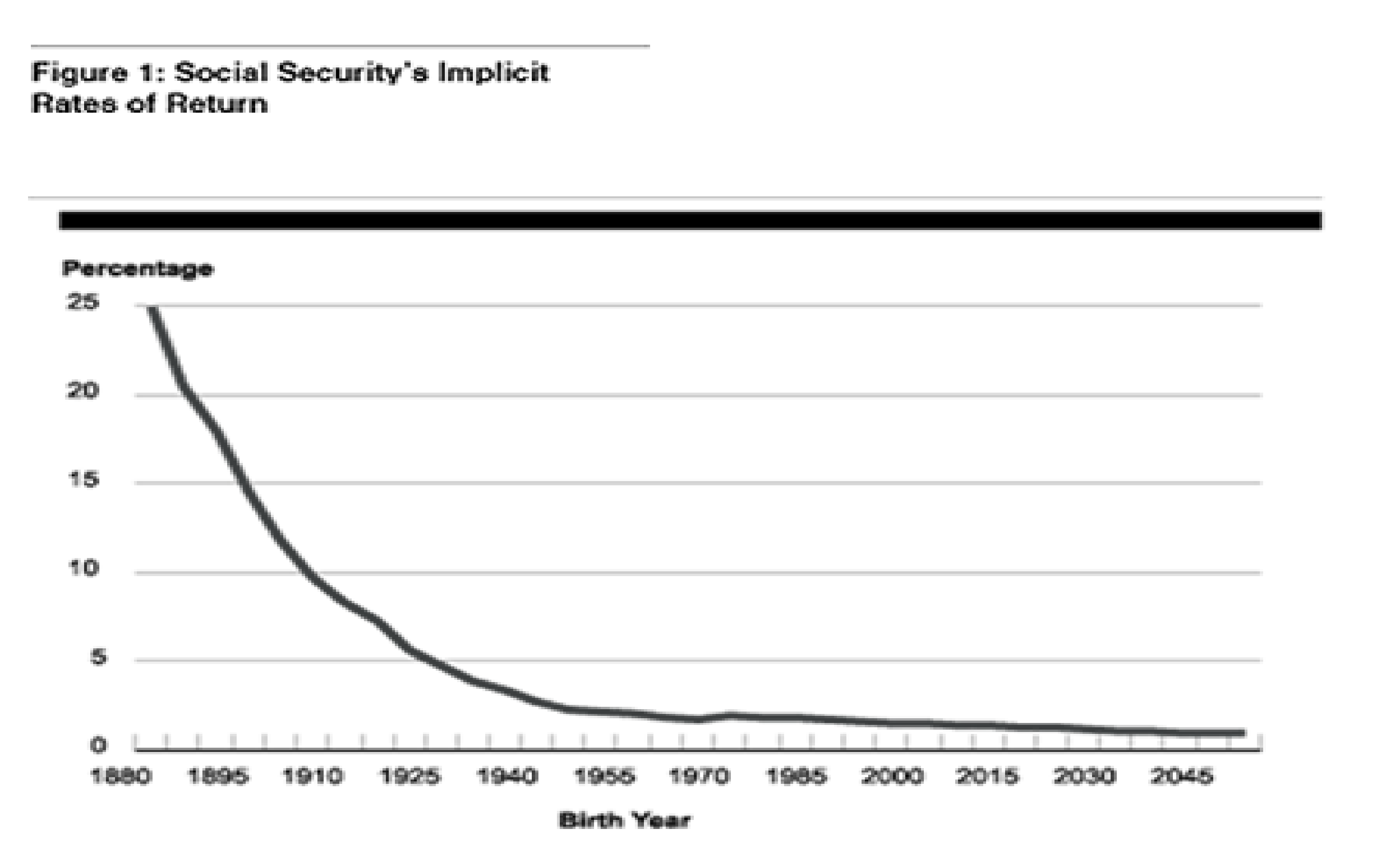
- Single workers paying the maximum tax into Social Security retiring in 2030 ***will have to live past 110*** simply to get back what they've paid in.

# Under PAYGO, Early Participants Reap Windfalls ….

- **Ida May Fuller** of Ludlow, VT, was the first to receive a monthly retirement check, in January, 1940, in the amount of $22.54. Miss Fuller, a legal secretary, retired in November 1939. She started collecting benefits at age 65 and lived to be 100 years old, dying in 1975.

- **Ida May Fuller** worked for three years under the Social Security program. *Her total payroll tax contributions to Social Security were $24.75. During her lifetime she collected a total of $22,888.92 in Social Security benefits.*

# The Maturing of a PAYGO System …




Source: GAO, 1999

# … While Younger Workers Pay Ever Increasing Taxes for the Same Benefits

- **FDR insisted that Social Security provide workers' retirement benefits on a basis that at least matched what they could purchase in the private insurance markets, and wanted a *funded* Social Security program to achieve this.**

- **FDR was very concerned about the unfunded liabilities that would arise in a pay-as-you-go system. His secretary of labor, Frances Perkins, said that he described building such a system as "immoral."**

- **Declining rates of return for our children and grandchildren threatens to undermine political support for Social Security.**

- **Imagine putting money into a bank that, instead of paying interest into your account, actually takes money out!!!**

# We must modernize Social Security to meet the needs of the new millennium

- More equitable treatment for working families
- Establish greater poverty protections for widows
- Reduce the financial burden on our children and grandchildren
- Improve the rate of return for all beneficiaries
- Create an asset that our children and grandchildren can control, free from the influence and political control of Congress

# Solutions? Cutting other programs would require drastic measures

- By 2018, the cash flow deficit in Social Security would require eliminating the programs the size of Head Start and the Special Supplemental Nutrition Program for Women, Infants and Children (WIC).
- By 2020, the cash shortfall will require cuts equivalent to eliminating the Department of Education, the Department of the Interior, the Department of Commerce and the Environmental Protection Agency, in addition to those listed above.
- By 2035, Social Security's needs would require elimination of all of the above, plus NASA, the Department of Veteran's Affairs, the Department of Energy, the Department of Housing and Urban Development (HUD), the Department of Justice and the National Science Foundation.
- In the end, the federal budget would consist of a military budget and a pension and healthcare program for senior citizens.

# Solutions? Increasing public debt merely shifts the burden to others

- The cash flow deficit (unfunded liability) in Social Security is ***$25 trillion*** (inflation adjusted), and grows every year we put off reforms.

- Issuing public debt merely shifts the burden of Social Security to other generations over time, it cannot reduce Social Security’s deficit.
  - All borrowing ultimately must be paid back via tax increases or reductions in government spending.

- This addition to public debt would be larger than the national debt at the end of World War II (as a percent of GDP) and would cripple the US economy.

# Solutions? Faster economic growth won't solve the problem

- Financial stability of the Social Security Trust Fund is more sensitive to demographic changes than economic changes.

- Stronger economic growth will only <u>delay</u> Social Security's budgetary crunch dates by a few years.

- Stronger economic growth will likely exacerbate the cash flow problem. Why?
  - Remember: your Social Security benefits are based on what you contribute in payroll taxes.
  - Although higher economic growth increases near-term surpluses, it also increases future benefit obligations of the Trust Fund.

# Solutions? Some Form of Investment

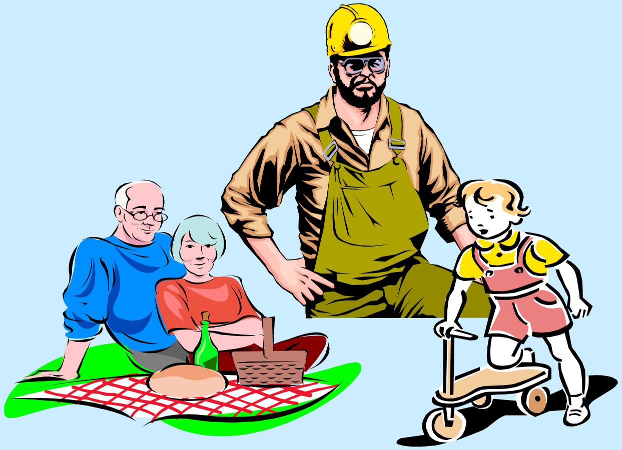
- Instead of trying to jam a square demographic peg through a round hole with tax increases or benefit cuts ('72, '77, '83), we could increase the rate of return on SS revenues.

- The 1994-96 Advisory Council on Social Security <u>unanimously</u> recommended some form of private sector investment to solve the program's long-term fiscal deficits.

- Federal Reserve Board Chairman Alan Greenspan: *"… we need to consider whether Social Security should better align itself with the funding provisions of our private pension and annuity system."*

# Who Should Own & Control Such Investment?

Washington Politicians?



Individual Workers / Beneficiaries?

# Government Ownership of Private Equities is Problematic

- **Alan Greenspan:** ***"It is highly unlikely that federal government investment can be accomplished free of political pressures that would distort the efficient use of capital."*** **(tobacco stocks? Non-union companies?)**

- **Inherent Conflict of Interest: How can the government be both regulator of the economy *and* fiduciary for Social Security beneficiaries? (E.G., even passive investment in S&P 500 would come into conflict with Justice Department's antitrust investigations of Microsoft)**

- **The U.S. Senate *unanimously* rejected (99-0) the notion of permitting the federal government to own shares of U.S. corporations (March, 1999).**

# Solution! Modernize Social Security with Personal Accounts

Personal accounts are:

- Flexible
  - Younger generations' money works for them while working or staying at home.
- Equitable
  - Resolve many of the inequities concerning divorce, dual-earner families, widow's benefits.
- Portable
  - Go with you as you change jobs, change spouses, and enter and exit the workforce.
- Empowering
  - Opportunity to create wealth from existing tax dollars.
  - Free workers from financial dependence (spouse, government).
  - Insulate retirement benefits from political risk.
  - Establish property rights to your Social Security benefit.
- Voluntary
  - Personal accounts would be voluntary – it's your money, it's your choice.

# The President's Principles for Reform

- Modernization must not change Social Security benefits for retirees or near-retirees.
- The entire Social Security surplus must be dedicated only to Social Security.
- Social Security payroll taxes must not be increased.
- Government must not invest Social Security funds in the stock market.
- Modernization must preserve Social Security's disability and survivors insurance programs.
- Modernization must include individually controlled, ***voluntary*** personal retirement accounts, which will augment the Social Security safety net.

# Personal Accounts: Myths and Realities

- **MYTH:** Personal accounts are simply a "risky investment scheme" invented by Wall Street.
- **REALITY:**
  - Opponents of personal accounts are the only ones who would force workers to invest in the stock market -- most plans provide individual choice, including the option to invest in safe, risk-free Treasury securities.
  - Most modernization proposals incorporate personal accounts that are only a small portion of the overall Social Security benefit (e.g. 2%).
  - Any personal account system will be voluntary.
  - Remember, this is saving and investing over the long term.

# Personal Accounts: Myths and Realities

- **MYTH: "Enron" Shows We Can't Incorporate Personal Accounts into Social Security**

- **REALITY:**
  - **The choice to invest your personal account in equities would be voluntary.**
  - **Workers who choose to invest their personal accounts would not hold shares in individual stocks. Rather, they would hold shares in an index fund, significantly diversifying (and minimizing) risk (a la federal TSP).**
  - **Enron employees were forbidden by their corporate executives to sell their stock. This would never be allowed in a government-administered retirement plan (e.g., federal TSP).**

# Personal Accounts: Myths and Realities

- **MYTH: Personal accounts mean benefit cuts.**
- **REALITY:**
  - **Opponents to personal account have the cause-and effect-backwards. Without personal account, today's workers already face a 30% cut in benefits under the current system.**

  - **Personal accounts provide enormous opportunities to create new wealth and expand benefits beyond what current law *is promising*, but cannot pay.**

  - **Every personal account proposal of the President's SS Commission would increase benefits, under intermediate assumptions, for those who selected it (enhance the safety net AND give every American the opportunity to create wealth).**

# Personal Accounts: Myths and Realities

- MYTH: Personal accounts will lead to greater poverty, especially among elderly women.

- REALITY: The poverty rate among elderly women is a failure of past policies, not of modernization plans yet to be adopted.
  - Current formula throws women into poverty when they become widowed.
  - Personal accounts don't affect the benefits of current or near retirees.
  - Personal accounts can be designed to enhance benefits for elderly women.

# Personal Accounts: Myths and Realities

- **MYTH: Personal accounts will benefit only the rich.**
- **REALITY:**
  - **Personal accounts would give low-income beneficiaries an asset to bequeath to their heirs and help create new wealth.**
  - **Lower and middle-income workers are most dependent on Social Security and thus have more to gain from a modernized system.**
  - **Personal accounts will help close the growing income gap between the rich and the poor by giving ALL Americans a share in the new economy.**
  - **Low-income workers are excited about the opportunity to own shares in GE, AOL, IBM, Disney, etc.**

# Personal Accounts: Myths and Realities

- **MYTH:** Personal Accounts would have tremendous "transition costs."
- **REALITY:** "Transition Costs" are misleading. Since the existing program will begin to run cash flow deficits in 2017, the transition costs of any Social Security reform must be measured against the "costs" of maintaining the status quo. For example, where is the government going to get $277 billion in the year 2030 alone – above and beyond payroll taxes – to pay promised benefits?
  - Transition costs to a more funded system are fixed; by contrast, the current program's unfunded liabilities keep growing each year.

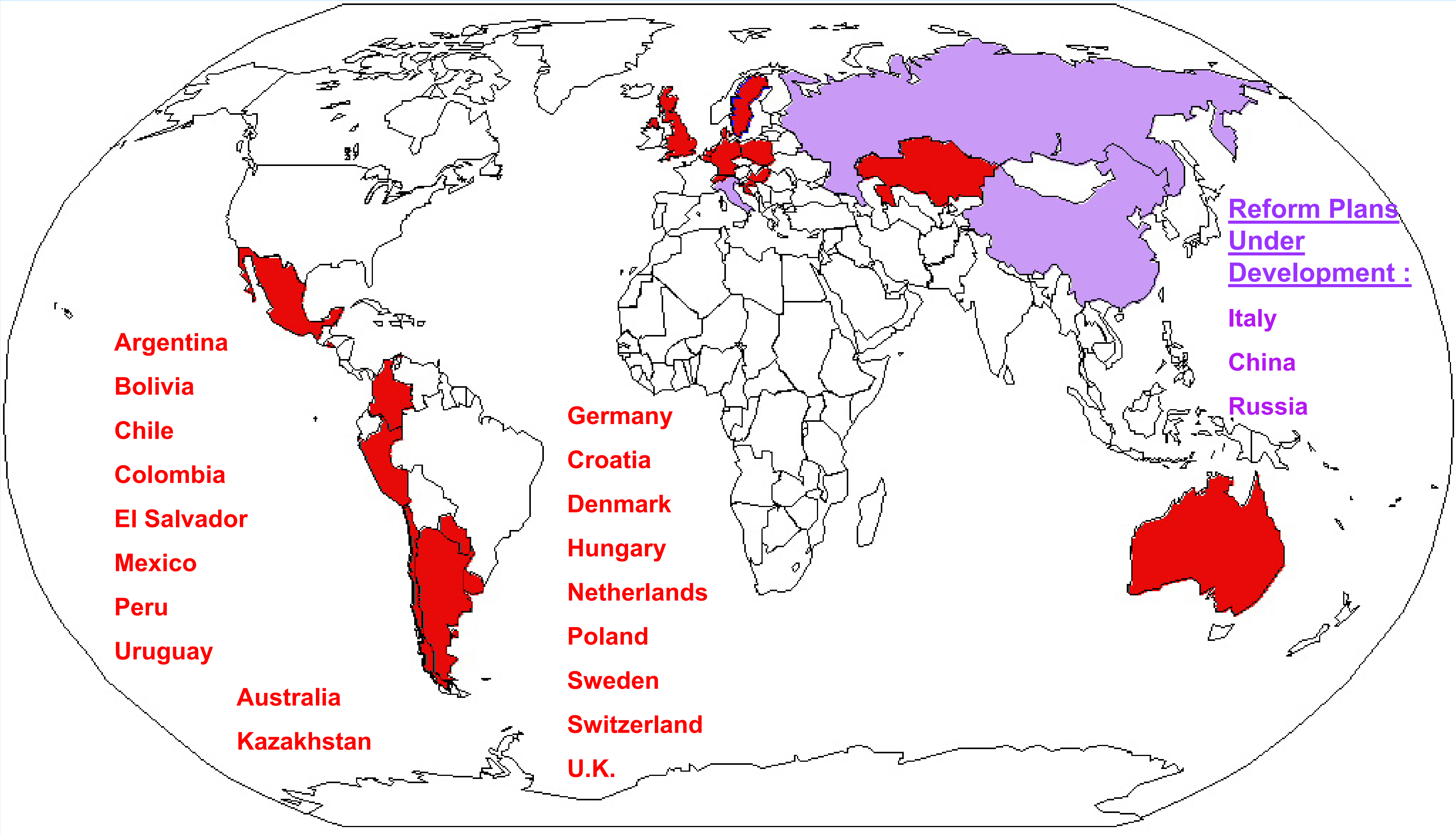
# Personal Accounts: Myths and Realities

- **MYTH**: Pre-funded public pension reform with personal accounts is "an untested theory."

- **REALITY**: Nearly two dozen other countries throughout the world have adopted such reforms with demonstrably sound success in terms of fiscal solvency and raising the living standards among the elderly.

  – The United States was among the last industrialized countries to adopt a public pension system, and we are one of the last yet to have adopted fiscally sustainable and actuarially sound reforms.

# Retirement Reform Around the World



# Personal Accounts: Myths and Realities

- MYTH: Middle and low-income workers are financially naïve and not able to invest for themselves.

- REALITY:
  - What the opposition is REALLY saying is “low-income workers are too stupid to invest.” This is patronizing and demeaning. Ask the average federal worker if he/she finds the TSP too risky or confusing.

  - Any modernized Social Security system will include an education campaign.

  - If workers in Third World countries and other developed nations can do it, so can U.S. workers.

# Personal Accounts: Myths and Realities

- **MYTH: Middle and low-income workers are financially naïve and not able to invest for themselves.**
- **REALITY:**
  - **One needs only to look at the compelling story of Ms. Oseola McCarty.**

    **– Ms. McCarty spent her entire life laundering shirts, never earning more than $9,000 per year. In fact, she had to drop out of school at the age of 13 to help support her family.**

    **– Then, in the early 1990s when she was in her late ’80s, she became an instant national celebrity when she donated $150,000 for a scholarship program at the University of Southern Mississippi. School officials were amazed that this woman of such modest means throughout her life could have accumulated such financial assets and a significant amount more. When asked this very question, she replied: "It was the magic of compound interest." With the help of a woman at a local bank, Ms. McCarty began at the age of 8 to put away a few cents each week, sometimes a few dollars, and compound interest did the rest.**

# Personal Accounts: Myths and Realities

- **MYTH**: **Personal Accounts are favored only by one party; there's no need to take action soon.**

- **REALITY:**
  - **Despite the financial crisis looming in Social Security, personal account plans are the only *bipartisan* reform plans out there.**
  - **During the last crisis (1983), Congress waited until Social Security was near bankruptcy before acting. The result? An income tax on benefits, a tax increase on workers, and an increase in the retirement age.**

# Keeping Social Security's Promises

- If we had advance warning of a major catastrophe -- a hurricane, a tornado, or a volcanic eruption -- we would strain every effort to prepare for its effects.

- Unfortunately we don't often receive that advance warning, and we are left instead with the enormous costs of dealing with catastrophes after they occur. But right now we know that because of changing demographics, Social Security's current course is unsustainable, and we would be doing a great injustice to posterity if we do not act to avert it.

- Nonpartisan experts agree that due to Social Security's extreme vulnerability to changing demographics (the Baby Boom and longer life spans), the promise of future benefits under the current program rests primarily on the willingness of future generations to be taxed at ever-increasing rates.

# Keeping Social Security's Promises

- Reasonable people can disagree about how best to restore Social Security to a path of long-term solvency.
- Regardless of one's philosophical or political leanings, it is critical that we not take refuge from reality by ignoring or downplaying the magnitude of the financing challenges that the Social Security actuaries clearly state are ahead of us ($24 trillion unfunded liability and growing).
- Remember:  If the government "guarantees"/promises the payment of a benefit, someone somewhere will have to pay for it.  We must not be seduced by blithe references to a Trust Fund full of IOUs that will somehow magically reconcile the benefits that the federal government is promising to pay, and the burden that is placed on taxpayers of the 21st century.

# Keeping Social Security's Promises


- Social Security is – and should always remain – an intergenerational compact of income support to protect against what FDR called "the hazards and vicissitudes of life."
- The question is not about keeping Social Security's guarantees. The question is about how we preserve the program's financial dependence at a cost that younger generations can bear.

# Keeping Social Security's Promises


- By strengthening the primary feature of the Social Security as we know it -- a guaranteed monthly benefit of social insurance based on sharing income between generations -- and supplementing it with a personal savings / wealth creation component, we can boost retirement security for every American.
- Only by beginning to "advance fund" Social Security – as FDR had intended -- can we avoid an ever-increasing tax burden on our children and grandchildren from crowding out our other vital public investments.
- But none of this is possible unless and until we agree to end our long collective silence about the character and problems of Social Security.

# The History and Future of Social Security

***"... it is inequitable to compel [workers] to pay more under [Social Security] than they would have to pay to a private insurance company."***

– Arthur J. Altmeyer, Chairman of the Social Security Board (1937 - 1946) and first Commissioner of the program (1946 -1953)

# The History and Future of Social Security

***"I do not believe that our present Social Security system is the last word, nor do I believe it should be immune to change. On the contrary, I believe it can, it should, and it will change and that each generation should be free to remake and remold it to its needs and likings."***



– Wilbur Cohen, early architect of Social Security

# The History and Future of Social Security

*"The most serious threat to our institutions comes from those who refuse to face the need for change."*